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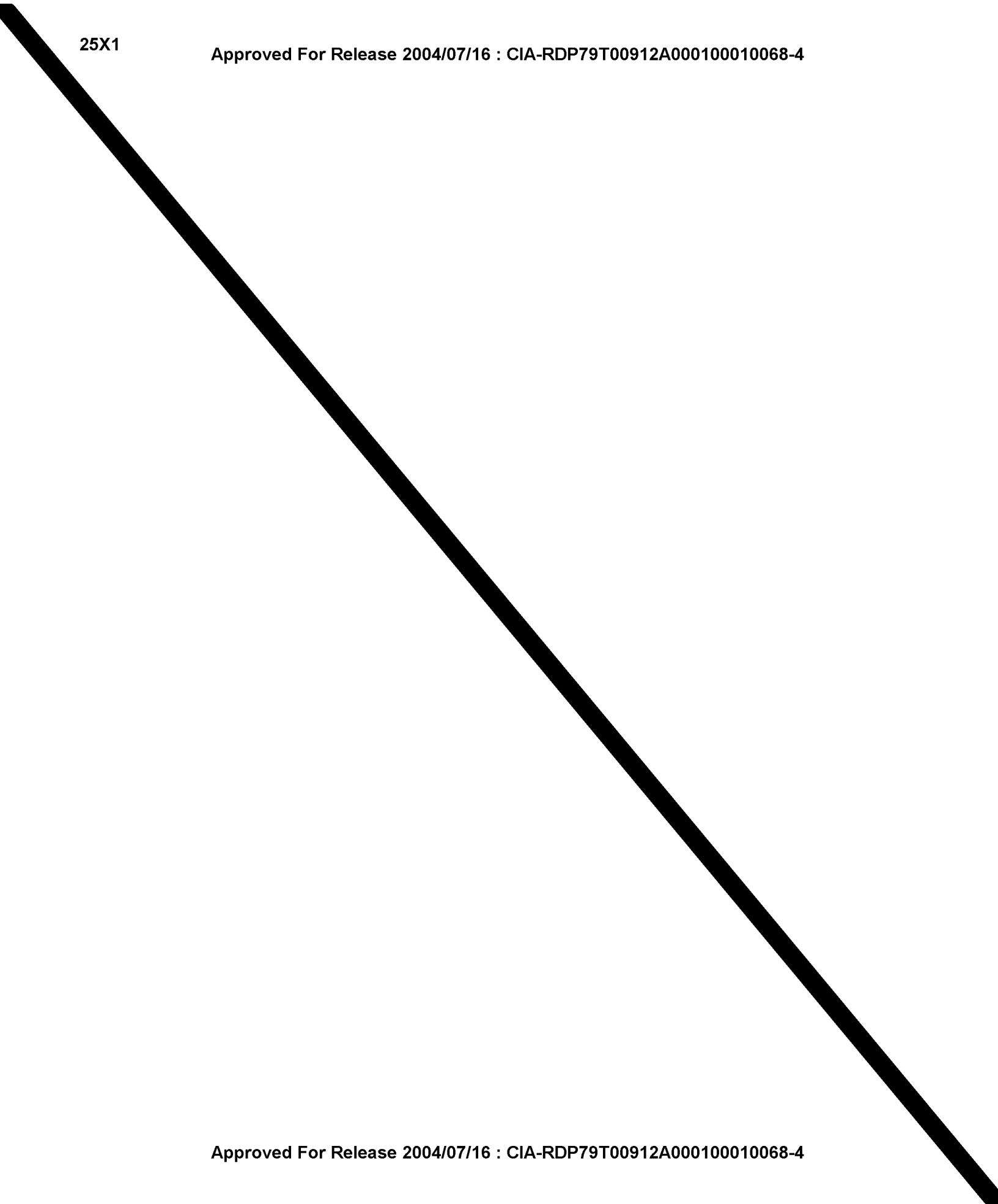

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USSR WEEKLY REVIEW

23 February 1978

CONTENTS

25X1

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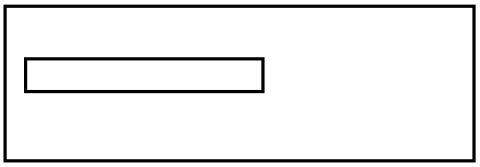

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Oil Policy and West Siberia

A surprisingly outspoken article on West Siberian oil development problems in a recent economic journal reveals substantial disagreement over technical policies in the oil industry, the balance of investment between the Urals-Volga and West Siberian oilfields, oil planning issues, and the transportation of West Siberian oil to the Far East. The discussion illuminates some tough decisions that confront Soviet economic policymakers and the highly uncertain nature of long-term oil planning. The author's proposed solutions could have significant foreign-economic and geopolitical implications.

Since the early 1970s oil industry specialists and administrators have argued over the proper balance that should be struck between investment in the increasingly depleted Urals-Volga oilfields and investment in new fields in Siberia. Confronted by large cost increases in the oil industry during the Ninth Five-Year Plan (1971-75), the Soviet economic leadership decided in 1974-75 to commit relatively more capital investment, drilling rigs, and crews than might have seemed justified from a longer range perspective to the maintenance of output in the Urals-Volga fields in the 10th Five-Year Plan (1976-80).

This policy decision represented a gamble that the enhanced recovery from the older fields would outweigh, or at least balance, additional production that might be anticipated from more rapid exploration and development of fields in West Siberia. The policy, which the Soviet planning chief N. K. Baibakov himself publicly lobbied for in 1974,* has recently been attacked by Dr. L. P. Guzhnovskii, an economist at the Tyumen (West Siberian) Department of Economic Research of the Institute for Economics and Organization of Industrial

*Ekonomicheskaya Gazeta *1974, No. 11, pp. 7-8.*

23 February 1978

Production of the Siberian Branch of the USSR Academy of Sciences. In the most recent issue of the branch's journal,* Guzhnovskii reveals:

-- A strong undercurrent of anxiety that oil and gas production plans will not be met, or will be met only at excessive cost, and a lack of faith that an effective planning strategy presently exists for meeting the Soviet Union's oil needs in the post-1980 period.

-- Continuing fierce competition between the European USSR and Siberia for resources in the oil industry, centering upon the possible revision of existing plans and the formulation of 11th Five-Year Plan (1981-85) priorities.

-- The hard choices that the formidable physical geography of Siberia might impose if larger volumes of oil had to be moved to the Far East, and the potential connection between Siberian transportation problems and Soviet involvement in the Middle East.

Regional Investment Priorities

Guzhnovskii builds his case for an acceleration of West Siberian development at the expense of older fields upon the assertion that costs are lower and labor productivity higher in Tyumen than in the Urals-Volga region. In his view it is a fundamental policy mistake to attempt to hold achieved levels of output in the older oilfields: "The concentration of effort on keeping up the extraction of oil in the Urals-Volga areas seems to us quite debatable." But, as he notes, this policy is an integral feature of the current 10th Five-Year Plan. Contrary to the rationale behind the 10th Five-Year Plan, Guzhnovskii argues that it would be far better to compensate for declining output in the older regions by increasing exploration and development "in the new oil regions with lower capital investments." Likewise, he claims it is a major error--because of the impact on

*"*The Siberian Contribution to the Oil Might of the Country*," Economics and Organization of Industrial Production *1977, No. 6*.

23 February 1978

oil production--to allow investment in social infrastructure in West Siberia to lag seriously behind that allocated to other oil-producing areas.

Noteworthy is Guzhnovskii's treatment of this "urgent problem" of regional investment priorities as a political question. "One cannot exclude the possibility," he observes, "of the conversion of the Urals-Volga area into a sort of counterweight to West Siberia and other new regions, as Azerbaidzhan was in 1948-50 to the Urals-Volga area." Mistakes have been made in the past; they are being repeated, he argues, in the 10th Five-Year Plan, and he implies that there are good reasons to suspect that they may be perpetuated in future allocations of investments among oil-producing regions.

Technical Policies

Guzhnovskii's attack on past and current regional development strategy turns in part upon controversial questions of technical policy in the oil and gas industries. He criticizes the infill drilling currently practiced in "regions of the European part of the country"--the Urals-Volga--as "the least effective method of stabilizing or slowing down a decline in the recovery of oil . . . especially in the final stage of exploitation of oilfields." This dense pattern of drilling--we might note--necessitates the allocation of more crews and drilling rigs (both in short supply) to the Urals-Volga and other older European USSR oilfields. Contrary to present practice, Guzhnovskii insists on the need to utilize new enhanced recovery methods in the initial stage of exploitation of oilfields, thereby implying a shift of resources from the older fields to West Siberia. His extremely heavy emphasis on the enormous economic loss involved in flaring associated gas also points toward greater investment in Tyumen Oblast of West Siberia.[1]

Guzhnovskii's advocacy of faster Tyumen development, earlier application of new enhanced recovery techniques, and greater recovery of associated gas would appear to imply that imports of Western equipment should be expanded, and he himself explicitly calls for "purchases of imported machinery" to solve the associated gas problem.

23 February 1978

Planning Difficulties

In developing his argument Guzhnovskii suggests that the planning process itself also inhibits correct utilization of West Siberian oil and gas resources. He criticizes earlier hasty and uncoordinated exploitation of West Siberian fields, the failure to use economic-mathematical models as a means of optimizing the territorial pattern of development, and a series of counterproductive prices, methods of calculating costs, and managerial success indicators. In passing, he reveals that no nationwide integrated programs exist for raising recovery rates through enhanced recovery or for mastering the associated gas problem. Despite the high priority of oil and gas extraction, his criticisms show that progress within these branches is significantly impeded by difficulties common to the entire Soviet economy.

Transportation

Guzhnovskii devotes a separate section of his article to "prospects of ocean shipments of oil." As Soviet Far East needs for oil expand, the volume of Tyumen oil that must be transported there will increase, since "the sources of local oil extraction will remain unchanged." (It is unclear whether Guzhnovskii was aware of the recent Sakhalin oil discovery when he wrote his article.) Consequently, determining "rational ways" of getting it there is becoming "increasingly important." Two alternative solutions to the problem are being considered: rail shipment based on doubletracking the Baikal-Amur Mainline (BAM) now under construction, and a pipeline. Guzhnovskii rejects both alternatives.[2] Instead, he urges consideration of "the possibility of transporting Tyumen oil in a southwestern direction through the Samotlor-Kuibyshev-Novorossiisk pipeline and then by sea through the Suez Canal to ports of the Far East and for export." This alternative, he acknowledges, would require "accelerated development of the tanker fleet of our country and construction of special docks, oil storage facilities and other structures." He justifies this circuitous route on the basis of cost factors and the need to move the oil without waiting for completion of BAM or construction of an extremely long pipeline. (According to his calculations, shipping oil by 50,000 ton tankers from Novorossiisk on the Black Sea would lower

transport costs to the Soviet Far East by 19 percent and to Japan by 30 percent.) Even if Tyumen oil were shipped around the Cape in 100,000-150,000 ton tankers this would still be more economical than the other alternatives.

Guzhnovskii's proposal reveals a perception of the very large volume of oil that is likely to be required soon in the Far East and of extreme difficulties in getting it there by inland means. There would clearly be serious political and military risks involved in a long-term commitment to ship a major share of the Soviet Far East's oil supply through the Turkish Straits, Suez Canal, Red Sea, and Strait of Malacca (or through Gibraltar and around the Cape). While Guzhnovskii does not mention it, his proposal calls to mind the economically more rational alternative of a commercial swap in which Soviet oil would be delivered to Western customers in exchange for deliveries from the Persian Gulf to the Soviet Far East--an alternative implying even greater vulnerability to unpredictable shifts in the Middle East and the world oil market. Even to float publicly the possibility of tanker shipments is impressive testimony to the urgency of the problem and the magnitude of investment costs of alternative solutions.

The fundamental dilemma of Soviet oil production, as some industry spokesmen have emphasized since the early 1970s, is not simply to meet the planned yearly increment, but to replace the progressively increasing drop in output from the depleted oilfields of the European USSR (and, soon, from those of West Siberia as well). Accumulating evidence suggests that the Soviets will not meet their current five-year plan targets for 1980, and there is no indication that the large new oilfields required to sustain output over the longer haul have yet been discovered. As demand for oil intensifies, as the input requirements for enhanced recovery in the older oil-producing regions rise, and as the need to find and develop new giant oilfields in northern Tyumen, East Siberia, and offshore areas weighs even more urgently on the Soviet leadership, the regional resource allocation issues raised in Guzhnovskii's article will become still more acute. Miscalculation in the treatment of these complex and dynamic issues is fully conceivable--the Soviets have no master plan for handling them. With such enormous stakes involved and so much uncertainty

about the best course of action, the controversy reflected in Guzhnovskii's discussion is likely to become more acrimonious as the strategy for the critical 11th Five-Year Plan (1981-85) is debated between now and 1980.

Footnotes:

1. "According to calculations of the 'Giprotyumenneftegaz' Institute," he observes, "utilization of associated gas at West Siberian fields is more economical than extracting oil in the Azerbaidzhan SSR." In the gas sector, Guzhnovskii urges that a much higher priority be assigned to the recovery of gas condensate--especially in the existing gas fields of Tyumen, as opposed to new gas and oil fields being opened up in northern Tyumen. Because of inadequate gas condensate processing capacity at the Tobol'sk and Tomsk petrochemical complexes now under construction, Guzhnovskii proposes that the question of building a condensate pipeline from the gas condensate fields to Ust'-Balyk be reviewed and that the existing oil pipeline from Ust'-Balyk to Omsk and Pavlodar be exclusively used for the transportation of condensate.

2. It is argued, Guzhnovskii notes, that double-tracking BAM would entail 6 percent lower capital investment costs than a single track with a parallel pipeline. But, in his opinion, "converting the Baikal-Amur Mainline into a specialized oil transport road would seriously impair utilization of BAM for shipping other freight and would have a negative influence on tempos of development of productive capacities in the BAM zone. Only about 20 percent of the transit capacity of the railway over and above shipments via BAM of oil and petroleum products could be used for the transport of other freight in an eastern direction." (And much of this 20 percent, presumably, would have to be assigned to military freight.) Also, use of BAM for oil shipments would clog western traffic with empty tank cars. Guzhnovskii rejects the pipeline proposal on the grounds that "technical realization of this proposal is inhibited by the existence of permafrost, a high level of seismic activity, and other negative phenomena. Operational expenditures for pumping oil are also increasing."

25X1

23 February 1978

25X1

Lada Exports to US Delayed

The introduction of the Soviet Lada passenger car into the US market remains stalled by its failure to meet US emission control standards. In 1975, the failure of 10 Lada passenger cars to meet US emission standards postponed their planned 1976 entry into the US market. Several Ladas were expected to be tested in 1977 for possible market entry in 1978, but as of November 1977 they were still in the USSR for undisclosed reasons.

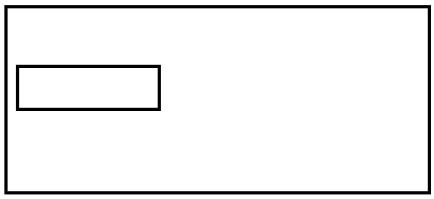
The 1978 domestic version of the Lada does not meet the 1978 US emission standards for carbon monoxide or hydrocarbon emissions. According to published Soviet data, carbon monoxide emissions exceed US standards by 30 to 190 percent; and hydrocarbons by seven to 73 percent. Catalytic converters, which are needed to raise Lada's performance to US standards, are not yet being serially produced in the USSR.

Plans call for Lada to be marketed through existing US automobile dealerships, initially in the eastern part of the United States. A parts distribution center is planned to ensure a stable supply of spare parts, although construction has not yet begun. If there are spare parts shortages in the US or in the USSR, some Fiat parts can be substituted--nearly half of the Lada parts can be interchanged with Fiat; other parts are available on special order from an Italian firm which will be able to manufacture about three-fourths of all Lada parts.

The Soviets expect Lada to receive cautious acceptance in the US. If sold in 1978, it will be competitively priced at $3,800-$4,200 and will come in two versions--sedan and station wagon. Lada will have an attractive interior design, and will be equipped with a new and more powerful engine (1,600 cc) requiring less maintenance than previous models. The USSR's goal is to sell 60,000 Ladas in the United States by 1982. At 1978 prices, that volume of sales would earn $230-$250 million in badly needed foreign exchange.

25X1

23 February 1978



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First Soviet Ammonia Arrives in the US

The first shipload of Soviet ammonia under a 20-year counterpurchase agreement involving Occidental Petroleum Corporation arrived in Florida last month. Over the period (1978-97) of the agreement, Occidental will buy an average of 1.5 million tons of Soviet ammonia per year--roughly 10 percent of US ammonia consumption in 1976--and one million tons each of urea and potash. In return, the USSR will purchase about one million tons of superphosphoric acid annually. They will use it to produce badly needed complex fertilizers. The volume of Soviet ammonia coming to the United States in 1978--perhaps 350,000 tons--will increase substantially by 1980 and continue at a high level through 1998.

Much of the material sold to Occidental is likely to be marketed in the United States. Occidental has also agreed to purchase additional quantities of Soviet ammonia (averaging 900,000 tons per year in 1978-87), at least part of which will be marketed outside the United States.

The sale in the United States of Soviet ammonia and urea (an ammonia-based fertilizer) will bring certain benefits, including an opportunity for the United States to reduce the amount of natural gas now used to produce ammonia. The Soviet materials may also give rise to problems, because existing US production capacity for ammonia and urea is not fully utilized. In addition, political repercussions could result if the Soviet material displaces ammonia now imported from other areas.

Potential Benefits

Production of ammonia, a highly energy-intensive process, requires large supplies of natural gas as feedstock. Imports of Soviet ammonia will reduce the drain on dwindling US gas reserves. Assuming that average annual sales in the United States of Soviet ammonia (including the ammonia in urea) average 2.1 million tons--worth more than $210 million at current prices--the potential annual savings of natural gas in the

United States would be equivalent to 2.3 billion cubic meters, nearly three-fourths of gas consumed in Virginia in 1976. Some energy will also be required to produce the superphosphoric acid but the energy balance clearly will be favorable to the United States. Also, much of the Soviet ammonia probably will be used to make diammonium phosphate (DAP). The United States is the world's largest producer and exporter of DAP, exporting $270 million worth of DAP in 1976.

The Other Side of the Coin

We estimate that world ammonia supply will exceed demand in the early 1980s. The large volume of Soviet ammonia going to the West under counterpurchase and compensation agreements by then--in excess of three million tons annually--probably is more than can be absorbed in markets that also will be feeling the impact of capacity increases in other regions. The resulting intense competition is likely to keep prices down and may force some high-cost Western producers out of the market. In the United States, about one-fifth of ammonia capacity was idle in 1977. The anticipated increase in US ammonia capacity between 1976 and 1980--about 5 million tons--will cover the expected increase in US consumption of ammonia.

Moreover, ammonia plants recently introduced or under construction in Canada and Trinidad were planned in part because of the prospect of US markets. US fertilizer producers are part owners of certain of the foreign plants and presumably will continue to use ammonia imported from these areas. Thus, displacement of ammonia imports from Canada, Trinidad, and other areas by imports of Soviet ammonia could cause political repercussions. [redacted] 25X1

23 February 1978